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The Supreme Court's Securities Act Reference Fails to Demonstrate an Understanding of the Canadian Capital Markets

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THE SUPREME COURT'S SECURITIES ACT REFERENCE FAILS TO DEMONSTRATE AN UNDERSTANDING OF THE CANADIAN CAPITAL MARKETS

Poonam Puri *

I. INTRODUCTION

In a decision released on December 22, 2011, the Supreme Court of Canada unanimously rejected the federal government's proposed Securities Act.¹ Using a formalistic federalism analysis, the court held that the proposed Securities Act as currently constituted is unconstitutional.² The court held that day-to-day regulation of securities is under provincial authority, while the regulation of systemic risk and data collection is appropriately under the federal government's general trade and commerce power.³ The court notes that a co-operative federalism approach is a way to establish a national regime.⁴

My reaction to the Supreme Court's decision is one of surprise and disappointment. The decision was extremely decontextualized; the court failed to appreciate the nature of a "market" and that it is comprised of buyers (investors) in addition to sellers (issuers). The court also failed to recognize the fact that the Canadian capital markets have evolved such that it is now national in character, and no longer local or regional. In comparing this decision to other reference cases over the last 22 years, I also reach the conclusion that the court had the tools to find in favour of a national securities regulator, but avoided doing so, in part, by stating that it did it could not deal with matters of policy or politics. Despite my

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1. *Reference re: Securities Act (Can.)*, 2011 SCC 66.
2. In a similar line of reasoning, the Alberta Court of Appeal and a majority of the Québec Court of Appeal also held the act is beyond the authority of the federal government: *Reference re: Securities Act (Canada)*, 2011 ABCA 77, per Slatter J.A., Côté, Conrad, Ritter and O'Brien J.J.A., concurring; *Québec (Procureure générale) v. Canada (Procureure générale)*, 2011 QCCA 591, per Robert C.J.A. and per Forget, Bich and Bouchard J.J.A. (Dalphond J.A. in dissent).
3. *Supra*, footnote 1, at para. 128.
4. *Ibid.*, at para. 132.

critique of the court's decision and reasoning, I believe that a national securities regulator is still possible and a goal worth pursuing.

This commentary is divided into three parts. First, I critique the decision of the court from a capital markets perspective. Second, I put the decision in context by comparing it to other reference decisions before the Supreme Court over the last 22 years. Third, I discuss options moving forward for national regulation of the Canadian capital markets in light of the Supreme Court's decision.

II. CRITIQUE OF THE DECISION FROM A CAPITAL MARKETS PERSPECTIVE

The court's decision is highly decontextualized and it does not demonstrate a clear understanding of the evolution and current state of capital markets in Canada.

The court characterized Canada's central claim as follows: "[T]he securities market has evolved from a provincial matter to a national matter affecting the country as a whole."⁵ On this issue, the court held that Canada "has not shown that the securities market has so changed that the regulation of all aspects of securities now falls within . . . s. 91(2)."⁶ The court cited a lack of evidentiary support for Canada's claim that capital markets have been transformed since their initial establishment.⁷

The court's statement that there was a lack of evidentiary support is puzzling, given the evidentiary record. The court had the benefit of expert reports by Professors Trebilcock and Milne filed by Canada as well as the handful of expert reports on securities regulator structure that have been produced in Canada over the last several decades. Instead of relying on these sources, the court held that the expert evidence confirms the *local nature* of Canada's securities industry.⁸ The court cites Suret and Carpentier's article on issuer headquarters:⁹

J.M. Suret and C. Carpentier, for example, point to different focuses and specializations from province to province (*Securities Regulation in Canada: Re-examination of Arguments in Support of a Single Securities Commission* (2010), Reference Record, vol. ix, 8). Mining listings compose approximately two thirds of the securities market in British Columbia.

5. *Ibid.*, at paras. 4 and 33.
6. *Ibid.*, at para. 6 (emphasis added).
7. *Ibid.*, at para. 116.
8. *Ibid.*, at para. 127.
9. *Ibid.*

About half of Ontario's securities market is attributable to large financial services companies. Alberta is the dominant national market for oil and gas and roughly a quarter of technology listings emanate from Québec.

My own research for the 2003 Wise Persons Committee also confirms that there are clusters of industry specialization across the country.¹⁰ It is accurate to state that British Columbia and Ontario host a high proportion of mining issuers, Alberta hosts a high proportion of oil and gas issuers, and Ontario hosts a high number of financial services issuers. However, the province in which the issuer is headquartered determines who the primary regulator is (and hence, where the regulatory expertise in mining, or oil and gas are located), but not much else. The reality for many issuers is that their investors are located throughout Canada, with nationwide or international and gross domestic product impact.¹¹ The location of the headquarters of an issuer does not determine where the market is and provides little explanatory benefit to understanding the scope of the capital markets.

It is more telling that two-thirds of reporting issuers in Canada are reporting in more than one jurisdiction, meaning that they are raising capital in more than one jurisdiction.¹² Companies with large market caps are typically national reporting issuers. Ninety-eight percent of Canadian market capitalization is allocated to large cap companies.¹³

Interestingly, only Dalphond J.A. of the Québec Court of Appeal held, in dissent, that capital markets are now national in nature.¹⁴ Dalphond J.A. states "[There is] a Canada-wide integrated capital market, where transactions are essentially interprovincial and international, a situation radically different from the one that existed in 1867 or even 15 years ago."¹⁵ Dalphond J.A.'s dissent appears firmly rooted in the prevailing discourse on the nature of capital markets. How is it possible that

10. See my paper on local and regional market interests for the Wise Person's Committee: Poonam Puri, "Local and Regional Interests in the Debate on Optimal Securities Regulatory Structure" (October 7, 2003), online: Wise Person's Committee, <http://www.wise-averties.ca/reports/WPC_6.pdf>.

11. *Ibid.*

12. Wise Person's Committee, "It's Time" (Ottawa, Department of Finance, 2003), at p. 5, online: Wise Person's Committee, <<http://www.wise-averties.ca/reports/WPC%20Final.pdf>>.

13. *Ibid.*

14. *Québec (Procureure générale) v. Canada (Procureure générale)*, *supra*, footnote 2, at paras. 395-545.

15. *Ibid.*, *per* Dalphond J.A., at para. 465.

only Dalphond J.A. came to this conclusion that is so well supported by the expert evidence on capital markets?

The answer to this question lies in how the issue was framed by the court. The court framed the issue as a purely federalism analysis where it would not delve into policy questions or political matters. This approach results in a decision that does not appreciate the current state of capital markets in Canada and does not chart a clear path forward for effective securities regulation for the benefit of all Canadians.

III. COMPARISON WITH OTHER REFERENCES BEFORE THE SUPREME COURT OF CANADA

To put the court's *Securities Reference* decision in context, I compared this reference decision to other reference decisions released by the Supreme Court since 1990. Upon comparison, I have observed that this decision is out of step with other major reference decisions in the application of the constitutional principle of a "living tree." In addition, the court's refusal to delve into policy issues or political matters is in sharp contrast to other significant reference decisions.

In the *Securities Reference*, the court reaches the conclusion that the proposed Securities Act sought to regulate the day-to-day activities of issuers and other participants in the securities market and that court held that "[t]hese matters have long been considered local concerns subject to provincial legislative competence over property and civil rights."¹⁶ This decision essentially sends the message that this is how we have always done it and therefore, we are going to continue in this way. This type of reasoning is problematic from a capital markets perspective as noted in Part II of this commentary above; it is also out of step with the constitutional principle of a "living tree."¹⁷

Since 1990, there have been 22 reference decisions released by the Supreme Court of Canada. Ten of those decisions have been on issues related to federalism. In a number of these decisions, the court has put the relevant issue in its full social, political and economic context and acknowledged changes in norms, practices

16. *Supra*, footnote 1, at para. 6.

17. An overview of the living tree doctrine of constitutional interpretation is available in: Peter W. Hogg, *Constitutional Law of Canada*, 5th ed. supp., vol. 1. (Scarborough, Ont., Thomson Carswell, 2007) (updated 2011, rel. 1), at 15.9(f).

and conventions over time. Additionally, the court has dealt with policy issues and political matters either explicitly or implicitly.

For example, in the 2004 *Reference re: Same-Sex Marriage*, the Supreme Court takes an explicitly more contextual approach. In that decision, the court outlines that marriage is not a fixed concept in constitutional law and that it is insufficient to consider how marriage was conceived at the time of Confederation, but instead how it stands today.¹⁸ Under the heading "The Meaning of Marriage Is Not Constitutionally Fixed," the court wrote:¹⁹

The "frozen concepts" reasoning runs contrary to one of the most fundamental principles of Canadian constitutional interpretation: that our Constitution is a living tree which, by way of progressive interpretation, accommodates and addresses the realities of modern life.

In holding that the concept of marriage has changed from being "between a man and a woman" to between two people, the court recognized the changes in relationships in modern society. In the *Securities Reference*, it appears that the court departed from understanding the "realities of modern life." In determining that the Canadian capital markets are local in nature, the court ignores the reality and the evidence that, for the most part, the Canadian market for capital is national in character and increasingly international in nature.

The court also seeks to avoid the issue of deciding on optimal regulation stating that the court is not deciding whether a national securities regulator is more effective from a policy standpoint.²⁰

[T]he policy question of whether a single national securities scheme is preferable to multiple provincial regimes is not one for the courts to decide. Accordingly, our answer to the reference question is dictated solely by the text of the Constitution [and] fundamental constitutional principles . . .

Whether the capital markets can be effectively regulated at the provincial level or whether federal regulation is necessary is indeed a policy question, but it is a policy question that requires the court to arbitrate. In other references, the court has dealt with issues that can only be reasonably considered to be policy issues and political matters and the court has addressed them explicitly or implicitly.

For example, in the *Secession Reference*,²¹ the court was asked whether Québec could unilaterally separate from Canada. The

18. *Reference re: Same-Sex Marriage*, [2004] 3 S.C.R. 698, at paras. 21-26.

19. *Ibid.*, at para 22.

20. *Supra*, footnote 1, at para. 10.

21. *Reference re: Secession of Québec*, [1998] 2 S.C.R. 217.

court's decision provides a clear example of addressing matters of policy and politics. The court held that a referendum on a clear question that confirmed a desire for Québec sovereignty establishes a "duty to negotiate" between the government of Québec, the Government of Canada and other relevant parties. The extensive reliance on a duty to negotiate was particularly surprising since the concept was not argued by any of the parties.²² Creating a duty to negotiate on the parties after a unilateral declaration of independence, when this was not even argued by the parties, could not be reasonably considered to be anything other than the court engaging in a policy decision in relation to a political matter.

IV. REALISTIC OPTIONS MOVING FORWARD ON NATIONAL REGULATION OF CAPITAL MARKETS

While earlier parts of my commentary critique the decision and the court's reasoning, this part of the commentary focuses on next steps and where we can reasonably go to from here. I will briefly discuss three possible options: (i) the status quo with provincial territorial regulation and a passport system; (ii) a national regulator narrowly focused on systemic risk; and (iii) a national regulator with a broad mandate achieved co-operatively with the "willing" provinces.

The problem with the status quo is that it is ineffective. While the Passport system achieves some efficiencies for issuers, there is still no single voice to represent Canada internationally and no one final decision-maker who runs the system and is accountable. Under the current system, enforcement issues both in the regulatory and criminal spheres continue to be problematic.

A second option would be to pursue a federal securities regulator that focuses on systemic risk. The Supreme Court indicated that a federal scheme aimed at systemic risk and national Canada-wide data management would be constitutionally valid.²³ This approach would require the drafting of federal legislation that is much narrower in scope and mandate than the Securities Act that was put before the court. In my view, this approach would require focusing on exactly what systemic risk means and how best to manage it. We would also need to give more thought on how systemic risk materializes in different ways. Presumably a national

22. Patrick J. Monahan, "The Public Policy Role of the Supreme Court of Canada in the Secession Reference" (1999), 11 N.J.C.L. 65, at p. 66.

23. *Reference re: Securities Act (Can.)*, *supra*, footnote 1, at paras. 117 to 121.

regulator based on systemic risk should regulate issuers, intermediaries and/or transactions that are above a certain size, scope or complexity and that are likely to cause concerns about systemic risk. Would issuers in certain industries be automatically regulated by this regulator? Would issuers above certain market capitalizations be regulated by this regulator? Which types of instruments and/or products would this regulator oversee? Would the regulator articulate specific, bright-line rules which would lay out which participants and products will be subject to its regulation or will the regulator rely on more general but less certain principles for the scope of its regulatory reach? My concern with this narrow approach to federal regulation based on systemic risk is that it would create a 14th regulator in the capital markets and not directly address the issues of accountability, duplication, inefficiency and ineffectiveness that cause us concern with the current system.

Finally, the third option for a way forward would be to engage in a co-operative federalism solution with the federal government negotiating a mutually acceptable solution with the provinces. The court recommends that the parties take a co-operative approach to meeting this federalism challenge.²⁴ As I understand it, this is precisely what the federal government and the Canadian Securities Transition Office have been doing to date, even though the legislation before the court was more absolute about the federal government's role in the proposed new environment. Of all the options available after the Supreme Court's decision, I believe this option is the best one moving forward. Even if a national securities regulator is restricted to the federal government and the "willing provinces," it will allow for greater accountability, actual decision-making authority, and more effective and efficient enforcement. This will result in Canadian capital markets that are more competitive, more efficient and fairer and that will better protect investors.

24. *Ibid.*, at para. 132.